

LAND DEVELOPMENT FINANCIER

HOW INTEREST RESERVES ARE STRUCTURED IN CONSTRUCTION AND DEVELOPEMENT DEALS

Illustration Of How Developers Get Into Financial Trouble

How They Are Generally Structured

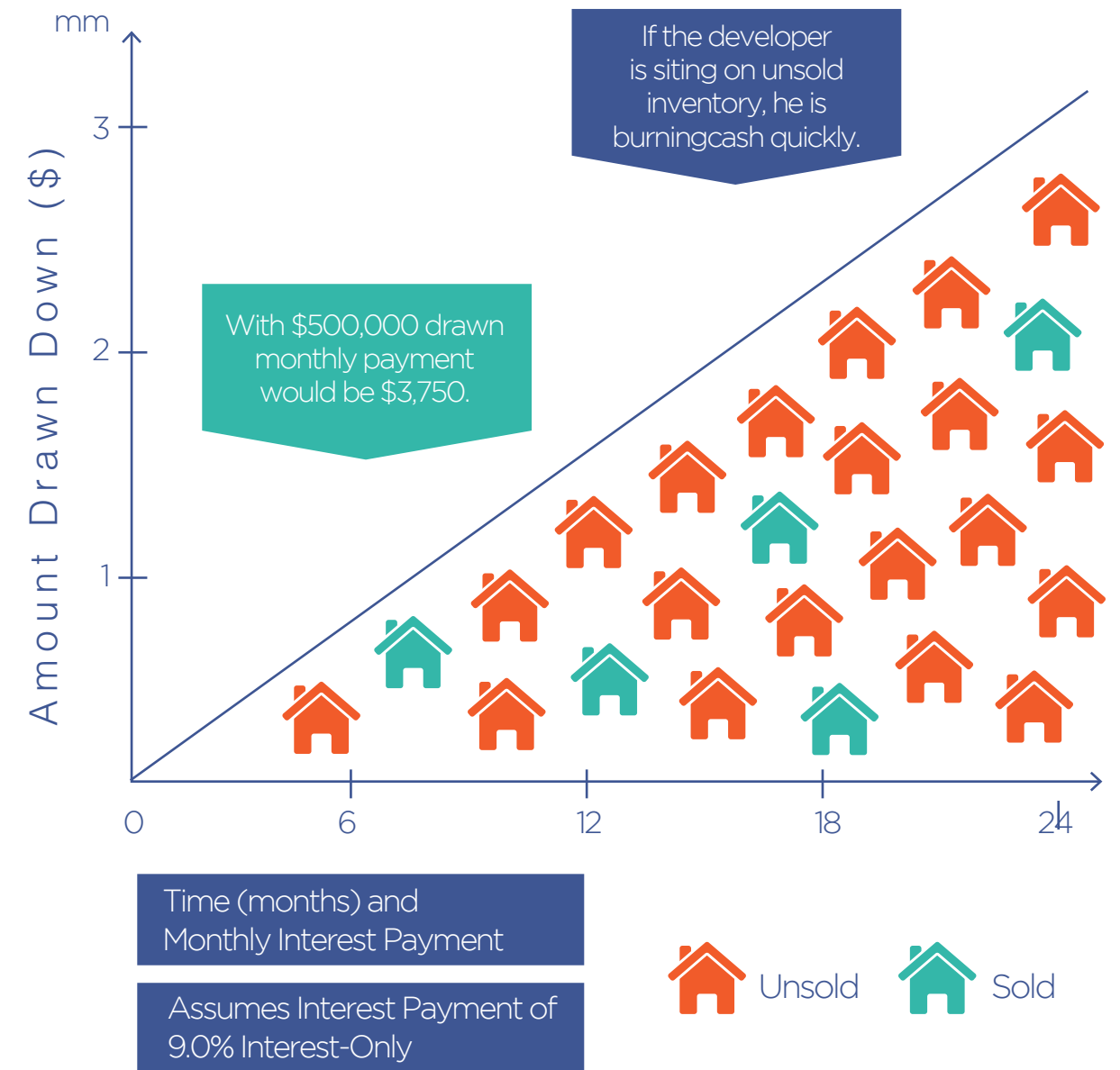
- ✓ Developer qualifies for a loan from a bank. These are generally interest-only loans.
- ✓ Interest is only paid only on the proceeds that are drawn down from the loan amount.
- ✓ The construction loan budget will contain an interest reserve, which is a pool of money set aside in a small savings account. This is meant to cover the construction period interest payments.
- ✓ Depending on how the loan is structured, the loan covenants may call for the loan's principal to be paid down at the time a property is sold or leased. This is also called "turbo amortization."
- ✓ If the developer is sitting on a lot of unsold inventory, the developer is on the hook for making interest payments, personally.
- ✓ If developer can't make the payments, then the bank may foreclose or the developer may place the project into bankruptcy to stop the foreclosure process and attempt to restructure his debt with the bank.

EXAMPLE OF A PAYMENT CALCULATION ON A SMALL INITIAL DRAW

Loan Amount: \$3,000,000
 Month 1 Draw Amount \$200,000
 Interest Rate: 9.0%
 Month 1 Payment: $\frac{200,000 \times 0.09}{12} = \$1,500$

EXAMPLE OF A PAYMENT CALCULATION ON A LARGER DRAW LATER IN THE TERM

Loan Amount: \$3,000,000
 Month 18 Draw \$1,500,000
 Interest Rate: 9.0%
 Month 18 Payment: $\frac{1,500,000 \times 0.09}{12} = \$11,250$



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